

Message Text

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ACTION ARA-20

INFO OCT-01 ISO-00 SP-03 AID-20 EB-11 NSC-07 RSC-01

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FM AMEMBASSY BRASILIA

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INFO AMCONSUL RIO DE JANEIRO

AMCONSUL SAO PAULO

UNCLAS SECTION 1 OF 2 BRASILIA 4852

E.O. 11652: N/A

TAGS: EFIN, BR

SUBJECT: FINANCE MINISTER SIMONSEN REVIEWS ECONOMIC TRENDS

1. SUMMARY: O JUNE 24, FINANCE MINISTER SIMONSIN, IN A PRESENTATION BEFORE THE BRAZILIAN SENATE ECONOMIC AND FINANCE COMMISSION, REVIEWED THE ECONOMIC SITUATION DURING THE FIRST SIX MONTH OF 1974 AND PRESENTED A RATHER OPTIMISTIC OUTLOOK FOR THE REST OF THE YEAR AND BEYOND. HE NOTED THAT PERFORMANCE OF MOST ECONOMIC INDICATORS TO DATE INDICATE THAT GROWTH RATE THIS YEAR MAY BE 10 PERCENT OR MORE. HE ASSERTED THAT THE RATE OF INFLATION DURING SECOND HALF SHOULD BE CONSIDERABLY BELOW THE 20 PERCENT OF FIRST HALF AND THAT, DURING THE NEXT TWELVE MONTHS, INFLATION SHOULD BE IN LINE WITH EXPERIENCES OF 1972 AND 1973. HE SAID CREDIT EXPANSION, WHICH DROPPED IN REAL TERMS THROUGH MAY, SHOULD PICK UP IN COMING MONTHS, EASING THE EXISTING TIGHT CREDIT SITUATION. ON BALANCE OF PAYMENTS FRONT, MINISTER STATED THAT CURRENT ACCOUNT DEFICIT IN 1974 WILL BE \$4.0 BILLION OR MORE, WHICH WILL BE FINANCED BY CAPITAL INFLOW, THUS OBVIATING NEED TO DECREASE OFFICIAL RESERVES. HE INDICATED THAT BRAZIL WILL

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NEED TO EXPAND ITS EXPORTS BY TWO BILLION PER YEAR IN COMING

YEARS TO MAINTAIN ITS FOREIGN DEBT ABSORPTION CAPACITY. THE EXPORT INCENTIVE SYSTEM COULD BE CHANGED, IF NEEDED, TO MEET THE GATT STANDARDS -- BUT IN NO CASE WILL THE LEVEL OF THESE INCENTIVES BE DECREASED. DURING QUESTION AND ANSWER PERIOD, THE MINISTER ALSO STATED THAT ADJUSTING THE MINIMUM SALARY IS NOT THE MOST IMPORTANT VARIABLE IN THE POLICY OF INCOME DISTRIBUTION AND THAT A "HOLE" OF 577 MILLION CRUZEIROS (ABOUT \$85 MILLION) IN THE ACCOUNTS OF HALLES IS WHAT LED TO THE CENTRAL BANK INTERVENTION IN THAT GROUP. END OF SUMMARY.

2. THE MINISTER SUMMARIZED THE MAJOR TRENDS OF THE ECONOMY DURING THE FIRST SIX MONTHS AS FOLLOWS: (A) MAINTENANCE OF A HIGH LEVEL OF INDUSTRIAL AND AGRICULTURAL PRODUCTION; (B) HIGHER RATE OF REGISTERED INFLATION OF ABOUT 20 PERCENT; (C) TRADE DEFICIT OF ABOUT \$2 BILLION; AND (D) DECREASE IN REAL LEVEL OF LIQUIDITY.

3. GROWTH RATE: SIMONSEN NOTED THAT CONTINUED HIGH LEVEL OF GROWTH PLACES BRAZIL IN AN ADMIRABLE POSITION IN THE CURRENT WORLD ECONOMIC PICTURE. HE STRESSED AGAIN THAT THE PRIMARY ECONOMIC GOAL OF GOB IS AN ACCELERATED GROWTH RATE AND THAT GOVERNMENT IS DOING ALL IT CAN TO PREVENT SLOWDOWN IN WORLD ECONOMY FROM HAVING AN ADVERSE IMPACT ON BRAZIL. AS INDICATIVE OF THE ECONOMY'S RAPID GROWTH, SIMONSEN CITED A NUMBER OF INDICATORS, INCLUDING THE FOLLOWING: (A) AGRICULTURAL PRODUCTION IN 1974 WILL GROW BY 8-10 PERCENT; (B) AUTOMOBILE PRODUCTION DURING JANUARY/MAY WAS UP 27.6 PERCENT OVER SAME PERIOD LAST YEAR AND HOUSEHOLD APPLIANCES UP BY 19.7 PERCENT; (C) PRODUCTION OF HIGH TEST GASOLINE AND DIESEL FUEL WERE UP DURING THIS SAME PERIOD BY 12.7 PERCENT AND 8.5 PERCENT, RESPECTIVELY, AND (D) ELECTRICITY CONSUMPTION INCREASED BY 14.7 PERCENT. THE MINISTER CONCLUDED FROM THESE RESULTS THAT THE ECONOMY IS MOVING AHEAD AT FULL SPEED AND THAT THE OVERALL GROWTH RATE IN 1974 SHOULD BE 10 PERCENT OR PERHAPS A LITTLE HIGHER.

4. INFLATION: SIMONSEN SAID THAT INFLATION RATE DURING FIRST HALF WAS ATYPICAL AND THAT DURING NEXT TWELVE MONTHS IT SHOULD BE IN LINE WITH LEVELS REGISTERED IN 1972 AND 1973. THE MINISTER ATTRIBUTED HIGH RATE OF INFLATION IN FIRST HALF

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TO (A) HIGHER IMPORT PRICES, WHICH ON THE AVERAGE WERE 60 PERCENT ABOVE THOSE OF A YEAR AGO AND (B) EXCESSIVE INCREASE IN THE MONEY SUPPLY DURING 1973. HE SAID THE GOVERNMENT WOULD CONTINUE TO CONTAIN INFLATION THROUGH AN ADEQUATE UTILIZATION OF PRICE CONTROLS, DECELERATING EXPANSION OF MONEY SUPPLY TO 35 PERCENT IN 1974 COMPARED TO 47 PERCENT IN 1973, LIMITING PRICE ADJUSTMENT OF PUBLIC SERVICES TO 15 PERCENT IN 1974, AND THROUGH A BALANCED BUDGET POLICY. HE STRESSED THAT GOB

REMAINS FIRM ON A GRADUALISTIC APPROACH TO INFLATION CONTROL. SIMONSEN NOTED THAT DURING LAST FIVE WEEKS, THE GUANABARA COST OF LIVING INDEX ROSE BY 1.66 PERCENT AS COMPARED WITH 2.4 PERCENT IN MAY AND 4.3 PERCENT IN APRIL.

5. BALANCE OF PAYMENTS AND FOREIGN DEBT: HIGHER OIL PRICES HAVE ADDED ABOUT \$2 BILLION TO BRAZIL'S CURRENT ACCOUNT DEFICIT IN 1974, WHICH IS NOW BEING ESTIMATED AT \$4.0 BILLION OR MORE. THE MINISTER STATED THAT ONE BILLION OF THIS IS EXPECTED TO BE COVERED BY DIRECT INVESTMENT INFLOWS AND THREE BILLION THROUGH AN INCREASE IN THE FOREIGN DEBT. HE NOTED THAT DESPITE THE HIGHER-THAN-EXPECTED TRADE DEFICIT THROUGH MAY, CAPITAL INFLOWS HAD BEEN SUFFICIENT TO BRING ABOUT AN OVERALL BALANCE. THUS, OFFICIAL RESERVES REMAIN AT \$6.4 BILLION AND BRAZIL HAS NO INTENTION OF SEEING THESE RESERVES DROP. BRAZIL WILL, THEREFORE, CONTINUE TO RELY ON POLICY OF ABSORBING FOREIGN CAPITAL AS A WAY TO FINANCE ITS CURRENT ACCOUNT. THE SUCCESS OF SUCH POLICY REQUIRES AN ADEQUATE GROWTH OF EXPORTS WHICH THE MINISTER SAID IS BEING PROGRAMMED AT TWO BILLION DOLLARS A YEAR OVER THE NEXT SEVERAL YEARS. FURTHERMORE, THIS OBJECTIVE WILL BE GIVEN HIGHER PRIORITY THROUGH EFFECTIVE MANAGEMENT OF EXCHANGE RATE AND THROUGH CREDIT AND FISCAL INCENTIVES. IF NECESSARY, HE CONTINUED, THE EXPORT INCENTIVE SYSTEM COULD BE CHANGED IN FORM -- TO MAKE IT CONFORM WITH GATT -- BUT THE LEVEL OF SUPPORT WOULD NOT REPEAT NOT BE DECREASED. THE MINISTER STRESSED THAT BRAZIL'S FOREIGN DEBT ABSORPTION CAPACITY IS RELATIVELY HIGH AND WILL REMAIN SO IN THE NEXT SEVERAL YEARS. HE NOTED THAT HIS PROJECTIONS INDICATE THAT IN 1978 THE RATIO OF NET DEBT (GROSS DEBT MINUS OFFICIAL RESERVE) TO EXPORTS WOULD BE AT THE 1972 LEVEL OF 1.34 PERCENT. THIS PROJECTION ASSUMES PESSIMISTICALLY, HE NOTED, THAT IN THE INTERIM BRAZIL EXPERIENCES AN ANNUAL CURRENT ACCOUNT DEFICIT OF \$4.0 BILLION, UNCLASSIFIED

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WHICH WOULD BE FINANCED BY ONE BILLION INFLOWS IN FORM OF DIRECT INVESTMENT AND THREE BILLION IN FORM OF INCREASED FOREIGN DEBT. CRIMMINS

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6. CREDIT AVAILABILITY: ACCORDING TO SIMONSEN MONETARY INDICATORS SHOW THAT POLICY OF TIGHTER CRDIT OUTLINED IN MONETARY BUDGET IS BEING FULFILLED. MONEY SUPPLY AND BANK CREDIT TO PRIVATE SECTOR FROM JANUARY TO MAY WENT UP 7.4 PERCENT AND 14.4 PERCENT, RESPECTIVELY, GIVEN THE HIGH RATE OF PRICE INCREASES DURING THIS PERIOD, THERE WAS A NET SQUEEZE IN REAL TERMS. HE SEES THE SITUATION IMPROVING DURING THE REST OF THE YEAR SINCE THE MONEY SUPPLY AND BANK CREDIT SHOULD RISE BY 23.7 PERCENT AND 23.4 PERCENT FROM JUNE TP DECEMBER, ACCORDING TO THE ESTIMATES OF THE MONETARY BUDGET.

7. INCOME DISTRIBUTION: DURING THE QUESTION AND ANSWER PERIOD FOLLOWING HIS STATEMENT, THE MINISTER WAS ASKED BY AN OPPOSITION SENATOR HOW THE GOVERNMENT JUSTIFIES THE DROP IN THE REAL MINIMUM SALARY DURING THE LAST TEN YEARS. AFTER ADMITTING THAT THE REAL MINIMUM SALARY HAD INDEED DECREASED, THE MINISTER WENT ON TO STRESS THAT THE MINIMUM SALARY IS NOT REPEAT NOT THE MOST IMPORTANT VARIABLE TO ANALYZE IN EVALUATING THE POLICY OF INCOME DISTRIBUTION. HE SAID THE GOVERNMENT CAN SET ANY MINIMUM SALARY IT WISHES BUT UNCLASSIFIED

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IT CANNOT GUARANTEE THAT PEOPLE WILL IN FACT EARN THAT LEVEL OF WAGE.

8. HALLES INTERVENTION: IN REPLY TO ANOTHER QUESTION, THE MINISTER SAID THAT A "HOLE" OF 577 MILLION CRUZEIROS (ABOUT

\$85 MILLION) WAS THE PRINCIPAL REASON FOR THE INTERVENTION
IN THE HALLES GROUP.

9. COMMENT: THE MINISTER'S ASSESSMENT OF THE ECONOMIC SITU-
ATION AND OUTLOOK WAS RELATIVELY OPTIMISTIC. HE CLEARLY BELIEVES
THAT

THE TRADE DEFICIT IN PARTICULAR AND THE BALANCE OF PAYMENTS
IN GENERAL DO NOT PRESENT INSURMOUNTABLE PROBLEMS, PRIMARILY
BECAUSE OF BRAZIL'S ABILITY TO ATTRACT FOREIGN CAPITAL.
WHETHER THIS ASSESSMENT IS A VALID ONE REMAINS TO BE SEEN,
PARTICULARLY IN THE LIGHT OF THE TRADE RESULT THROUGH MAY
WHICH CAUSED THE GOB TO RESTRICT MANY IMPORTS OF CONSUMER
GOODS. OFFICIAL BALANCE OF PAYMENTS PROJECTIONS TO DATE HAVE
BEEN VERY WIDE OF THE MARK. WHERE THE MINISTER SEEMS TO
BE MUCH CLOSER TO THE TARGET IS ON INFLATION, WHICH IS IN
FACT ON A DOWNWARD TREND, AND ON THE GROWTH RATE, WHICH WILL
PROBABLY BE CLOSE TO 10 PERCENT IN 1974.

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